

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-72441; File No. SR-OC-2014-02)

June 20, 2014

Self-Regulatory Organizations; OneChicago, LLC; Notice of Filing of Proposed Rule Change to Update OCX's Rulebook for Filings Previously Made with the Commodity Futures Trading Commission

Pursuant to Section 19(b)(7) of the Securities Exchange Act of 1934 (the "Act")<sup>1</sup>, notice is hereby given that on May 14, 2014, OneChicago, LLC ("OneChicago," "OCX," or the "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule changes described in Items I and II below, which Items have been prepared by the self-regulatory organization. The Commission is publishing this notice to solicit comments on the proposed rule changes from interested persons. OneChicago has previously filed these rule changes with the Commodity Futures Trading Commission ("CFTC"). OneChicago filed written certifications with the CFTC under Section 5c(c) of the Commodity Exchange Act ("CEA")<sup>2</sup> between June 19, 2012, and July 9, 2013 (the "Review Period").

I. Self-Regulatory Organization's Description of the Proposed Rule Change

OneChicago is proposing to file with the SEC certain rule changes and Notices to Members ("NTMs") that the Exchange has previously filed with the CFTC, but did not file with the SEC. Those rule filings and NTMs relate to reporting, sales practices, and OCX's obligation to enforce the securities laws.

Rule Changes Relating to Reporting

During the Review Period, OneChicago issued one NTM interpreting OCX's reporting requirements. NTM 2012-13, which was filed with the CFTC on June 19, 2012, provides

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<sup>1</sup> 15 U.S.C. 78s(b)(7).

<sup>2</sup> 7 U.S.C. 7a-2(c).

guidance with regard to the requirement that market participants trading bilateral blocks and Exchange of Future for Physical (“EFPs”) on OCX report the trades “without delay.”

#### NTM 2012-13

Market participants trading bilateral EFPs in accordance with OCX Rule 416 or bilateral blocks in accordance with OCX Rule 417 must report their trade to the Exchange without delay. The requirement that bilateral block trades be reported without delay is codified in OCX Rule 417(c). NTM 2012-13 clarifies the term “without delay” with regard to the reporting of a block trade, and also extends the “without delay” reporting requirement to EFPs.

In order for trade prices to accurately reflect current market conditions, OneChicago requires market participants trading blocks and EFPs bilaterally to report their block and EFP trades to the Exchange without delay. NTM 2012-13 provides guidance by interpreting the term “without delay.” NTM 2012-13 provides that the term “without delay” means that a bilateral block trade or EFP trade must be reported to the Exchange within five minutes of the deal being completed.

The NTM notes that the five minute requirement exists during normal market conditions. There may be extenuating circumstances in which it is not possible for, or reasonable to expect, a market participant to report a trade or series of trades within five minutes. For example, firms may require additional time to report a trade when reporting multiple fills simultaneously. Furthermore, since OneChicago’s Block and EFP Trading System (“OCX.BETS”) requires that one party post and the other party accept a trade, the NTM explains that the posting party must post the trade within five minutes, and the accepting party then has five minutes from the time of posting to accept the trade.

#### Rule Changes Relating to Sales Practices

During the Review Period OCX made three filings related to Sales Practices. Two of those filings, NTM 2012-14 and NTM 2013-09, relate to the requirement that an executing firm fully disclose the price of EFP trades to its customer. These two filings apply to all EFPs executed on OneChicago, regardless whether executed bilaterally or electronically. The other filing, NTM 2013-12, relates to the requirement that a firm engaging in a payment for order flow arrangement disclose the existence of such an arrangement to its customers.

#### NTM 2012-14

On July 2, 2012, OneChicago filed NTM 2012-14 with the CFTC. NTM 2012-14 allows for the practice of “marking up” or “marking down” (collectively “marking”) the cash leg of an EFP when trading an EFP for a customer.<sup>3</sup> An EFP involves the simultaneous purchase (sale) of futures and sale (purchase) of stock. The price of the EFP is represented by the difference between the stock price and the futures price. For example, if an EFP buyer buys futures at \$30.75 and sells the underlying stock at \$30.25, that EFP buyer is said to have paid \$0.50 for the EFP.

NTM 2012-14 imposes the requirement that a firm executing EFPs for a customer provide the original stock price that the executing firm received on the trade. This requirement allows EFP customers to be fully informed as to amounts they are being charged by the executing firm for transacting an EFP. Pursuant to NTM 2012-14, if an EFP executing firm is able to execute the EFP for \$0.40, but wishes to charge a \$0.10 execution fee/commission, the firm may adjust the stock portion of the EFP to account for the fee. For example, if the stock

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<sup>3</sup> OCX issued NTM 2012-14 to provide guidance to its market participants because uncertainty had developed regarding the permissibility of markups and markdowns in EFP trades. Markups (and by extension markdowns) are generally permissible in the securities industry. See NASD IM-2440-1; Securities Exchange Act Release No. 3574 (June 1, 1944); Securities Exchange Act Release No. 3623 (Nov. 25, 1944). See also FINRA Regulatory Notice 13-07 (January 2013).

price of the EFP is \$30.35, the executing firm may give the customer a stock sell price of only \$30.25. However, that executing firm must disclose to the customer that it was able to sell the stock for \$30.35. Essentially, NTM 2012-14 requires firms executing EFPs on behalf of customers to fully disclose the “built in” commissions they are charging their customers.

The NTM goes on to allow member firms facilitating EFP trades to execute the stock leg of the transaction as principal, provided that the member firm can demonstrate that the stock leg was passed through to the customer who traded the EFP.

#### NTM 2013-09

On April 3, 2013, OCX filed NTM 2013-09 with the CFTC. NTM 2013-09 expands upon the disclosure requirement imposed by NTM 2012-14. In addition to providing the execution price to customers, the executing firm must also provide the net and gross price of executing the EFP. In other words, the EFP customer must be provided with the EFP execution price on its own, and the EFP execution price including the markup or markdown. In the example above, the EFP executing firm built its commission into the stock leg of the EFP. The firm received a stock sale price of \$30.35 (for a gross EFP cost of \$0.40 to the customer), but marked the sale price down to \$30.25 (for a net EFP cost of \$0.50 to the customer) in order to receive its \$0.10 commission. In such a case, the executing firm must provide the gross EFP price (\$0.40) and the net EFP price (\$0.50), which includes any markup or markdown.

OneChicago believes imposing this additional requirement allows customers to be fully informed as to the commissions they are paying to transact an EFP because displaying the gross and net EFP price makes it easy for customers to determine fees they have been charged.

#### NTM 2013-12

On July 9, 2013, OCX filed NTM 2013-12 with the CFTC. NTM 2013-12 requires market participants engaging in payment for order flow arrangements to disclose such arrangements to its customers. Payment for order flow commonly refers to the practice whereby a firm routes orders to a liquidity provider in exchange for a fee paid from the liquidity provider to the referring firm. Before issuing NTM 2013-12, OneChicago became aware that firms trading OCX products were engaging in payment for order flow arrangements. Without endorsing or prohibiting such arrangements, NTM 2013-12 imposes the requirement that firms engaging in payment for order flow must disclose that fact to their customers. The NTM goes on to explain how firms may comply with the disclosure requirement, including (i) by providing notice within the customer confirmation; (ii) by placing a notice on the firm's public website; or (iii) by incorporating the disclosure within its customer account agreements.

Rule Changes Effectuating OneChicago's Obligation to Enforce the Securities Laws

During the Review Period, OneChicago filed several rule changes relating to its obligation to enforce the securities laws. OCX Rule 701 provides the Exchange authority to enforce Exchange Rules and Applicable Law, which the OCX Rulebook defines as "the CEA, [CFTC] Regulations, the [Securities] Exchange Act [of 1934], Exchange Act Regulations and margin rules adopted by the Board of Governors of the Federal Reserve System, all as amended from time to time."<sup>4</sup> Therefore, rule changes to OCX's disciplinary process, which is generally contained in OCX Rulebook Chapter 7, relate to OneChicago's obligation to enforce the securities laws. Between July 20, 2012 and March 4, 2013, OneChicago made a series of rule changes to its rules relating to its disciplinary process. OneChicago made the below rule changes to generally comply with the Core Principles and Other Requirements for Designated Contract

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<sup>4</sup> OCX Rule 104.

Markets,<sup>5</sup> which implements Section 735 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.<sup>6</sup>

#### July 20, 2012 Rule Changes

On July 20, 2012, OneChicago filed (revised filing submitted August 1, 2013) rule changes to amend OCX Rules 701 (General), 702 (Respondent Review of Evidence), 703 (Conducting Hearings of Disciplinary Proceedings), 704 (Decision of Disciplinary Panel), 705 (Sanctions), and 706 (Appeal from Disciplinary Panel Decision, Summary Impositions of Fines and Other Summary Actions).

Rule 701 generally grants the Exchange jurisdiction to enforce its rules as well as Applicable Law. The Rule specifically permits Exchange staff to carry out investigations and requires market participants to comply with those investigations. Rule 701(d) in particular allows market participants to be represented by counsel during any OCX inquiry, investigation, or disciplinary proceeding. OneChicago proposes to amend Rule 701 by prohibiting market participants from choosing counsel that may have a conflict of interest. Specifically, the rule provides that “counsel may not be a member of the Board [of Directors of OneChicago] or disciplinary panel, any employee of the exchange or any person substantially related to the underlying investigation such as a material witness or respondent.”

OCX Rule 712(a) allows respondents in a disciplinary hearing commenced by OneChicago to “review all books, records, documents, papers, transcripts of testimony and other tangible evidence in the possession or under the control of the Exchange that the Department will use to support the allegations and proposed sanctions in the notice of charges or which the

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<sup>5</sup> 77 FR 36612 (June 19, 2012).

<sup>6</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203, 124 Stat. 1376 (2010).

chairman of the Disciplinary Panel deems relevant to the disciplinary proceedings.” OneChicago proposes to amend Rule 712(a) by clarifying that although respondents in disciplinary hearings are permitted broad access to OCX documents that will be entered in a disciplinary proceeding against the respondent, the respondent will not have the right to inspect documents prepared by an Exchange employee that will not be entered into evidence in the disciplinary proceedings, any documents that may disclose guidelines or investigative techniques, or any other documents from a confidential source. OneChicago believes this rule change will allow respondents to access documents related to a disciplinary proceeding, without compromising Exchange work product, investigatory techniques, or confidential sources. The proposed rule change preserves the Exchange’s ability as a self-regulatory organization to enforce its rules and the securities laws.

OCX Rule 713 generally outlines the procedure OneChicago staff must follow in conducting a disciplinary proceeding. OCX Rule 713(g) allows for the recording or transcription of any hearing conducted in connection with a disciplinary proceeding. OneChicago is proposing to amend Rule 713(g) to state that such recordings will become part of the record of the proceedings.

OCX Rule 714 describes the process by which the Disciplinary Panel must issue an order rendering its decision. Rule 714(b) requires that an order contain certain items and lists those items. OneChicago is proposing to make technical amendments to Rule 714(b) to more specifically describe the items required to be included in an order. The amendments proposed by OneChicago do not materially alter the contents of the order; rather, the amendments will require more specificity from the order, particularly with regard to an explanation of the evidentiary basis for the Disciplinary Panel’s finding.

OCX Rule 715 grants OneChicago authority to impose sanctions on a respondent after notice and opportunity for a hearing in accordance with the OCX Rulebook. Rule 715 lists the type of sanctions that the Exchange may impose on a respondent. OneChicago is proposing to add subparagraph (c) to OCX Rule 715 in order to clarify that any sanction imposed by the Exchange against a respondent must be sufficient to deter recidivism and must take into account the respondent's disciplinary history.

OCX Rule 716 allows a respondent to appeal from a Disciplinary Panel Decision. Rule 716(i) requires the Appeals Panel to render its decision in a statement of findings of fact and conclusions. OneChicago is proposing to amend Rule 716(i) to require, in addition to such statement of findings of fact and conclusions, a complete explanation of the evidentiary and other basis for such finding and conclusions.

#### August 3, 2012 Rule Changes

On August 3, 2012, OneChicago filed (revised filing submitted August 6, 2012) rule changes to amend OCX Rule 307 and the cover page of the OCX Rulebook. OCX Rule 307 lays out OneChicago's jurisdiction and requires market participants to be bound by all Exchange Rules. The list of market participants over whom OneChicago has jurisdiction is specified in OCX Rule 307(a). OCX Rule 307(a) imposes jurisdiction on Clearing Members, Exchange Members or Access Persons who access or enter any order into the OneChicago System. OneChicago is proposing to expand its jurisdiction to capture "any person initiating or executing a transaction on or subject to the Rules of the Exchange directly or through an intermediary, and any Person for whose benefit such a transaction has been initiated or executed." The proposed amendment further states that such persons are subject to the requirement that they comply with investigations and disciplinary processes initiated by OneChicago. This amendment will expand

the scope of OneChicago's jurisdiction and allow it to gather more information in its investigations in order to more accurately and fairly enforce Exchange Rules.

In addition to modifying OCX Rule 307, the amendment adds a disclaimer to the cover page of the OCX Rulebook. That disclaimer mirrors the language of the amendment to OCX Rule 307(a). The purpose of this amendment is to make clear the scope of OCX's jurisdiction to market participants upon first accessing the OCX Rulebook.

The foregoing amendments were prepared and filed in consultation and in unison with other Designated Contract Markets registered with the CFTC. Additionally, the language of the above rule changes was approved by the CFTC prior to filing.

#### August 29, 2012 Rule Changes

The August 29, 2012 rule change further modifies OCX Rule 307. Specifically, OneChicago proposes to add subparagraph (d) to OCX Rule 307. Subparagraph (d) clarifies that any person who is not a Clearing Member, Exchange Member, or Access Person, but who is still subject to OneChicago's jurisdiction pursuant to OCX Rule 307, is bound to comply with Exchange Rules to the same extent that the aforementioned market participants are. Proposed OCX Rule 307(d) then lists the Exchange Rules that such market participants are bound to comply with. The listed rules span most of the Exchange Rulebook, including chapters 4, 5, and 6, which generally deal with business practices and trading rules.

#### February 27, 2013 Rule Changes

OCX Rule 127 defines the Disciplinary Panel, which oversees Disciplinary Proceedings. Previously, Rule 127 required that the Disciplinary Panel consist of three individuals from the Exchange's Board and/or Exchange Members. The February 27, 2013 amendment (substantively revised March 3, 2013) proposes to remove the requirement that Disciplinary

Panel members be Exchange Members, and allows for Disciplinary Panel members to be selected from the public (and who would otherwise meet the requirements of selection as a Public Director). OneChicago believes this amendment will broaden the scope of market participants and members of the public that are eligible to serve as members of the Disciplinary Panel, thereby increasing the diversity of views and interests represented by the panel.

The rule filings and NTMs are attached as Exhibit 4 to the filing submitted by the Exchange but are not attached to the published notice of the filing.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, OneChicago included statements concerning the purpose of and basis for the proposed rule changes and discussed any comments it received on the proposed rule changes. The text of these statements may be examined at the places specified in Item IV below. The self-regulatory organization has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The purpose of OneChicago's filing is to update the OCX Rulebook to account for various filings OneChicago has previously made with the CFTC, but has not made concurrently with the SEC. Specifically, the purpose of rule filings and NTMs are to (1) clarify the obligations of market participants with regard to reporting requirements; (2) require certain disclosures relating to sales practices; and (3) update OneChicago's disciplinary process to comply with the Core Principles and Other Requirements for Designated Contract Markets, which implements Section 735 of the Dodd-Frank Wall Street Reform and Consumer Protection

Act of 2010.

2. Statutory Basis

OneChicago believes that the proposed rule change is consistent with Section 6(b) of the Act,<sup>7</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act,<sup>8</sup> in particular, in that it is designed to foster cooperation and coordination with persons engaged in facilitating transactions in securities, and remove impediments to and perfect the mechanism of a free and open market and national market system. OneChicago believes that clarifying its reporting requirements helps foster regulatory certainty for its market participants who trade bilateral blocks and EFPs. Furthermore, requiring certain disclosures be made by firms trading on behalf of customers helps ensure a free and open market in which customers are made fully aware of transactions executed by executing firms on their behalf. Finally, the changes to OCX's disciplinary process will allow the Exchange to more effectively regulate trading activity.

B. Self-Regulatory Organization's Statement on Burden on Competition

OneChicago does not believe that the rule changes will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. The Exchange believes that the proposed rule changes are equitable and not unfairly discriminatory because they merely clarify the obligations of parties that transact EFPs, enhance customer protection through disclosure, apply to all market participants equally, and strengthen OCX's disciplinary process to ensure that trading activity and the disciplinary processes on the Exchange remains fair, equitable, and competitive.

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<sup>7</sup> 15 U.S.C. 78f(b).

<sup>8</sup> 15 U.S.C. 78(f)(b)(5).

C. Self-Regulatory Organization’s Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Comments on the OneChicago proposed rule change have not been solicited and none have been received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

OneChicago filed the proposed rule changes with the CFTC between June 19, 2012 and July 9, 2013. OneChicago did not file the proposed rule changes concurrently with the SEC. Instead, OneChicago filed the proposed rule changes on May 14, 2014.<sup>9</sup>

At any time within 60 days of the date of effectiveness<sup>10</sup> of the proposed rule change, the Commission, after consultation with the CFTC, may summarily abrogate the proposed rule change and require that the proposed rule change be refiled in accordance with the provisions of Section 19(b)(1) of the Act.<sup>11</sup>

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or

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<sup>9</sup> Section 19(b)(7)(B) of the Act provides that a proposed rule change filed with the SEC pursuant to section 19(b)(7)(A) of the Act shall be filed concurrently with the CFTC.

<sup>10</sup> Section 19(b)(7)(C) of the Act provides, *inter alia*, that “[a]ny proposed rule change of a self-regulatory organization that has taken effect pursuant to [Section 19(b)(7)(B) of the Act] may be enforced by such self-regulatory organization to the extent such rule is not inconsistent with the provisions of this title, the rules and regulations thereunder, and applicable Federal law.”

<sup>11</sup> 15 U.S.C. 78s(b)(1).

- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-OC-2014-02 on the subject line.

Paper comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-OC-2014-02. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal offices of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer

to File Number SR-OC-2014-02, and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>12</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>12</sup> 17 CFR 200.30-3(a)(12).